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## THE CAPITALIZATION OF THE INTERNATIONAL MERCANTILE MARINE COMPANY.

THE International Mercantile Marine Company completed, on December 31, 1903, its first year of life as a going concern. Up to the date of this writing, if stock quotations are any indication of its financial condition, the success of the company, from a market standpoint, is problematical. Its preferred stock is quoted at 18 and its common stock at 5, prices which indicate a general conviction that the equity in the company is worth little.

There is, however, a possibility that the stock market may be mistaken in its estimate of Mercantile Marine. In a declining market, stock values are influenced more strongly by the financial necessities of holders than by the earning power of the companies whose ownership they represent. This is especially true of the stocks of corporations launched on a declining market where the influence of every adverse factor is exaggerated. International Mercantile Marine has, in this respect, been peculiarly unfortunate. It was brought out during the fall of 1902, when the decline in the market was in full swing, and after the public buying power had been exhausted. Under the circumstances, these securities had no chance of a favorable reception. Moreover, almost from the start they were subject to inside pressure. The English vendors, stimulated by some natural distrust of the unknown economies of combination, and strenuously exhorted thereto by the financial press of Great Britain, which has been from the outset hostile to the combination,<sup>1</sup> sold the stock which

<sup>1</sup> For example, the *Economist*, on November 29, 1902, referring to the report that certain English vendors had expressed a desire to receive bonds in lieu of cash, remarked as follows: "They (J. S. Morgan and Co.) also state that the offer was made on the expressed desire of some shareholders, who wished to invest in the bonds. If that be the case, it seems to imply a singular lack of busi-

they received in payment for their interest, and the members of the American underwriting syndicate, as well as the American vendors, hard pressed by the continued stringency in the money market, have contributed to the selling pressure.

The proposition should be considered on its merits, without special reference to the market price of the company's securities.

The outstanding capital of the Mercantile Marine Company is divided as follows:

Underlying bonds . . . . .	\$16,000,000
20-year collateral debenture bonds (4½ per cent) . . . . .	52,000,000
Preferred stock, cumulative (6 per cent) . . . . .	54,600,000
Common stock . . . . .	<u>48,000,000</u>
Total . . . . .	\$170,600,000

To pay interest and preferred dividends — common dividends, at least for some years to come, are hardly to be expected — will require the following amounts:

Interest on underlying bonds, taken at 5 per cent . . . . .	\$ 800,000
Interest on debentures . . . . .	2,340,000
Dividends on preferred stock . . . . .	<u>3,276,000</u>
Total . . . . .	\$6,416,000

Following the practice of the older German and English companies and allowing 60 per cent of net earnings for depreciation, insurance and renewals, the total requirements, letting these funds include the sinking fund, are \$16,000,000.<sup>1</sup>

ness capacity on the part of the vendor shareholders, since they need not seek far to find securities with a much greater margin of security than these bonds to return a higher rate of interest. All they do know is that its capitalization will be enormously in excess of that of the undertakings that have been absorbed in it, and none should be better aware than themselves of the difficulty that will be met with in earning dividends on such a large sum, since they have had the experience of the same difficulty with a much smaller capitalization."

<sup>1</sup> The bonds of the International Navigation Company, of which \$13,686,000 are outstanding, call for a sinking fund of \$250,000 to \$500,000 annually, beginning May 1, 1905, which will retire the bonds at maturity in 1929. No sinking fund is provided for the bonds of the International Mercantile Marine Company, but they are subject to call at 105 after five years. If an adequate reserve is provided, the necessity of a sinking fund on bonds secured by shipping property does not appear.

Shortly after the Mercantile Marine Company was organized, the statement was made, unofficially, but apparently on good authority, by the *Wall Street Journal*, that the average net earnings of the different fleets for four years were \$6,107,675. The same authority stated that the estimated savings in the cost of operation for the year were \$10,000,000. Adding these to the average profits above mentioned, the earnings of 1903 should have amounted to a sum sufficient to pay dividends on the preferred stock, although it was not expected that any disbursement would be made. In other words, accepting the corporation's own estimate of the economies which can be secured by its changes in administration, the amount of its earnings falls short of the amount necessary to pay dividends on the common stock.

Before proceeding further in the analysis, let us test the accuracy of this conjectural estimate by comparing these figures with the amount actually earned by other companies during 1902, a year which was more favorable for the shipping industry than 1903. Such a comparison is presented in the following table:

	TONNAGE	NET EARNINGS	NET EARNINGS PER TON
Cunard Company . . . . .	114,410	\$ 1,235,750	10.80
North German Lloyd . . . . .	583,042	4,392,500	7.53
Hamburg-American . . . . .	651,151	4,458,198	6.85
International Mercantile Marine . .	1,034,884	16,107,000 (est.)	15.57

It thus appears that the estimated tonnage earnings of the Shipping Trust for 1903 are nearly twice the average amount — \$8.39 — which was earned during the preceding year by its leading competitors. Moreover, the German companies have for many years operated under a close pool which secures them all of the economies which the Shipping Trust was organized to obtain. Unless some other factors shall be discovered by the combination to increase its earnings, these preliminary estimates will eventually require some revision.

Accepting the same figure of tonnage earnings for the Shipping Trust which was attained in 1902 by its competitors, namely \$8.39 per ton, we have next to inquire how the combination measures up to its interest and dividend requirements.

The net earnings of the company, on this basis, would stand at \$8,941,398, leaving \$5,801,398 over fixed charges, for depreciation, renewals, and replacements. This amounts to about \$5.60 per ton as compared with \$4.30 per ton for the Hamburg-American Line in 1902, \$6.19 for the North German Lloyd, and \$8.04 for the Cunard Line. If we debit the earnings of the International Mercantile Company with \$5.00 per ton for these various necessary expenses, an amount which, considering the age of their fleet and the necessity of providing for the redemption of their bonds, would seem to be no more than is required, and if we assume, as before, their tonnage earnings at \$8.39 per ton, the Trust has only \$606,978 remaining for its preferred stockholders. That this supposition is not wide of the truth, may be seen from the experience of the North German Lloyd Company in 1902, which earned, over interest, 14,770,000 marks, and credited to renewals and insurance all but 212,477 marks of this amount, reducing their dividend payments from 5,278,131 to 210,623 marks. Taking a three years' average of the earnings of the Cunard, Hamburg-American, and North German Lloyd Companies, we find that their combined depreciation and insurance charges amount to \$24,719,112 out of \$37,976,794 of net earnings, or about 65 per cent. It is impossible to escape the conclusion that the Shipping Trust must appropriate a similar proportion of its profits for the service of the company, if the first care of its management is for the property of the company. If this is done, however, a readjustment of the capital of the company is among the probabilities.

We have not reached the end of the chapter. The Shipping Trust was organized during a period of great prosperity, when the earnings of ocean transportation, although depressed somewhat below the abnormal figures of 1900, were still large. To pass final judgment upon its financial future, it is necessary that we cast backward and discover, if possible, from the history of other shipping companies, what may be expected if earnings follow the course of former years.

In the accompanying table appears the income account of the Cunard Company for a period of twenty years, including 1883 and 1902.

## CUNARD STEAMSHIP LINE.

	PROFITS, INCLUDING BALANCE FORWARD	RESERVED FOR DEPRECI- ATION	RESERVED FOR IN- SURANCE	TOTAL BALANCE	DIVIDENDS	FOR- WARD	IN- SURANCE FUND STANDS AT
	£	£	£	£	£	£	£, Often Written lb.
1902	263,617	158,722	24,686	68,808	64,000 (4%)	4,807	357,000
1901	226,022	167,900	5,766	65,984	64,000 (4%)	1,984	350,000
1900	553,241	284,488	119,037	143,434	128,000 (8%)	15,434	350,000
1899	294,856	173,223	34,247	83,527	80,000 (5%)	3,527	260,000
1898	261,691	172,169	29,496	57,663	56,000 (3½%)	1,663	235,000
1897	222,475	166,938	27,999	41,691	40,000 (2½%)	1,691	212,000
1896	249,788	184,822	32,417	42,181	40,000 (2½%)	2,181	202,000
1895	144,305	180,325	. . .	183,731 <sup>1</sup>	. . .	{ deb. int. 1,466 }	187,000
1894	94,953	177,104	. . .	183,020 <sup>2</sup>	. . .	2,072	230,000
1893	200,091	154,419	39,966	35,868 <sup>3</sup>	32,000 (2%)	3,868	322,000
1892	174,607	125,856	33,496	36,296 <sup>4</sup>	32,000 (2%)	4,296	317,500
1891	220,991	125,426	38,407	52,382	48,000 (3%)	4,382	315,000
1890 <sup>5</sup>	246,601	125,840	43,144	72,838	64,000 (4%)	8,838	280,000
1889	350,203	130,573	{ 41,918 54,480 }	175,469	96,000 (6%)	4,988	240,000
1888 <sup>6</sup>	314,736	{ 135,327 23,000 }	{ 46,815 40,472 }	130,172	64,000 (4%)	2,700	. . .
1887	254,482	135,500	77,839	41,143	40,000 (2½%)	1,143	{ Debenture debt re- duced from £450,000 to £96,000
1886	160,910	137,721	23,189	nothing left	nothing left	. . .	{ Loss of Oregon costs £113,241
1885	165,943	141,506	24,437	nothing left	nothing left	. . .	140,000
1884 <sup>7</sup>	103,948	{ 87,018 23,000 }	nothing left	nothing left	{ . . .	. . .	117,000
1883	146,920	93,134 <sup>8</sup>	50,094	. . .	none	1,270	150,094

<sup>1</sup> £39,426 from insurance fund.<sup>2</sup> £88,067 from insurance fund.<sup>3</sup> £30,000 from insurance fund.<sup>4</sup> £25,000 from insurance fund.<sup>5</sup> The company had on hand at the end of 1890 in investments, bills, and cash, £559,922.<sup>6</sup> £96,000 debentures paid off July 1st. Balance of cash and investments, £205,804.<sup>7</sup> £23,000 taken from insurance fund and added to sum reserved for depreciation.<sup>8</sup> Depreciation fund stands at £302,000.

The feature of the movement which will immediately impress the reader is the extraordinary fluctuations of net earnings. From a minimum of £103,948 in 1884, they rose to a maximum of £350,203 in 1889, an increase of 237 per cent. From that point, although fairly maintained until 1893, they fell in 1894 to £94,953, the smallest figure ever reached. The depression continued during 1895, but in 1896 began the great upward swing which carried earnings up more than 550 per cent, to the enormous total of £553,241 in 1900. From this maximum, the decline was rapid, profits standing at £226,022 in 1901, and £263,617 in 1902. Passing over, for the time being, the explanation of these remarkable fluctuations, let us examine the disposition of profits which this company employed. We note at once that the reserves for depreciation took up a large share: £3,104,011 out of a total of £4,650,380. Another large amount, £787,905, or 16½ per cent of the total, went to the insurance fund, which the company has always maintained at a high figure. Out of the surplus remaining, to which was added £182,493 from the insurance fund, bringing the total amount available for distribution up to £940,957, £848,000 was paid in dividends, leaving £93,957 to be carried forward, an amount successively included in the annual profits. In other words, out of £4,650,380 of profits earned in 20 years, the Cunard Company paid out £848,000, or 18.8 per cent to its owners, and kept 81.2 per cent in the business. We note, moreover, that the disbursement of dividends was by no means regular. In six years out of the twenty, nothing was paid on the stock. In five other years, less than 3 per cent was paid, and in only one year, 1900, was as much as 8 per cent distributed to stockholders.

We note also with what extreme care the directors guarded their insurance and depreciation funds, taking every occasion of large earnings to build up these safety deposits, and refusing to sacrifice to the temporary advantage of the owners the permanent welfare of the company. In thirteen years out of the twenty, the profits of the company exceeded £200,000, aggregating £3,658,794. Of this amount only £816,000 was paid in dividends, £2,842,794 being carried to reserve. The shareholders reaped no small benefits, however, from their enforced self-denial. In

four years of the period 1892-95, the insurance fund, which is held in cash and securities, was drawn upon for dividends or to maintain the depreciation fund. Of the £64,000 paid out to stockholders during these four years, £55,000 came from the reserves.

In short, it was only by the most careful economy, by the utmost prudence and conservatism in the distribution of profits, that the Cunard Company was able, over a twenty-year period, to average 2.6 per cent to its stockholders and, during the past ten years, to earn 3.1 per cent on a capital which at no time exceeded the book value of its ships.

For an explanation of the irregularity of these profits, we turn to the nature of the industry. The shipping business is, of all industries, the most irregular. It is liable not merely to the usual alternations of prosperity and depression, but to sudden fluctuations of rates and traffic which are entirely without parallel in any other branch of trade.

To begin with, the industry is strictly competitive. The high seas can never be monopolized. Dockage facilities in the leading countries are open to the ships of all the world, and shipyards will furnish a cargo steamer at a moderate price. Under these conditions, a permanent control of the shipping industry, sufficient to maintain rates or to control traffic, is out of the question. Agreements among the regular lines may introduce a certain degree of stability into passenger rates, and into the freight charges on the higher classes of commodities, but for the great mass of traffic, the raw materials and rough and half-finished products of commerce, carriers and shippers will continue, as they have from time immemorial, to make their individual bargains, and the rates of charge will continue to be fixed by the higgling of the market.

This situation has two consequences. If at any port the supply of shipping waiting for cargoes exceeds the amount of business offered, the competition between owners will force rates down sometimes to the smallest admissible margin above operating expenses. The amount asked by the marginal ship will fix the rate for the time being for all vessels leaving the port. On the other hand, a small excess of tonnage offered will have an equal



effect in raising the rate. Some classes of commodities can be delayed in shipment longer than others, and some vessel owners can afford to lay up a portion of their tonnage rather than accept unremunerative rates. Generally speaking, however, the rule holds good. From every port and on every line of traffic, the rates are constantly changing in a way which would stagger a railway traffic manager, although he was deeply versed in the theory and practice of rebates and special concessions.

For example, take the following table of outward rates on coal from Wales to various ports in 1899:

	s. d.		s. d.	PER CENT OF VARIATION
Port Said . . . . .	7 9	to	13 6	74
Genoa . . . . .	7 6	"	11	47
Aden . . . . .	11 6	"	16 6	43
Bombay . . . . .	12	"	18 6	54
Colombo . . . . .	12	"	19	59
Cape Town . . . . .	19	"	30	58
Rio Janeiro . . . . .	11 6	"	16	39

The movement of grain rates from the United States, while less irregular than the figures quoted above, is also subject to wide variations.

Examples of more extreme fluctuations are easy to find. The course of rates in the British market in 1896 offers a typical illustration of the extreme instability of ocean rates. The *Economist*, in its annual review of the shipping industry for 1895, reported, at the close of that year: "The tonnage afloat is enormously in excess of the world's requirements, and so long as this continues we cannot see that there will be an improvement." During the early part of 1896, this condition of extreme depression continued. Only in outbound rates to the East, where the China-Japan troubles made a brisk demand for shipping, was any profit presented. These rates advanced, and remained on a high level throughout the year. A large number of ships, finding no profitable employment at home, went out to the East. Once there, however, and the war ended, they could not get back again, for return freights were not to be had, and it was impossible to return such a long distance in ballast without the pros-

pect of remunerative employment. This situation left a large number of cargo vessels stranded in eastern ports, unable to get back to western waters. A large part of the world's carrying trade was thus locked up. The available supply of shipping was suddenly diminished. The tonnage afloat accessible to English shippers was no longer as in 1895, "enormously in excess of the world's requirements."

Upon a straitened supply was now precipitated an avalanche of orders. Says the *Economist* :

The corn trade in the past year assumed a novel and unexpected position; the production of the world was slightly short of the consumptive requirements, . . . two of the large producing and exporting countries (India and Australia) being actually converted into considerable importers, and several hitherto small importers making largely increased demands.

The general trade of the country, as the *Economist* notes, maintained the improvement and expansion awakened and started more than twelve months earlier.

These combined influences came to bear on the freight market almost simultaneously; shippers of nearly every description, all wanting the same thing at the same moment, with a rather short supply of the article; result, blind competition sending up the price of tonnage by leaps and bounds, in many cases 200 to 300 per cent, from the end of September to the end of November. . . . By so much as the rise was rapid, by so much was the decline equally rapid, and at the close of the year we find freights all around, in every trade, worse if anything than at the commencement.<sup>1</sup>

This experience has been repeatedly duplicated in every market. It is true that the total supply of ocean shipping will in time become available to relieve any congestion ; but much time must often elapse before relief can be extended, the tonnage must be moved at once, and the ship-owners who are fortunate in being on the spot reap a rich harvest. On the other hand, vessels which have gone out in ballast to Argentine or the United States, expecting full cargoes of grain, or which have made the long

<sup>1</sup> Commercial History and Review of 1896. *Economist*, vol. lv, supplement, p. 25.

voyage to Australia, expecting a large movement of wool, suffer the full effects of a crop failure or a small wool clip.

The following table shows the fluctuations over a ten-year period in four of the leading items in the world's export trade.

YEAR	EXPORT OF WHEAT FROM U. S. Bushels	PER CENT OF CHANGE FROM PREVIOUS YEAR	EXPORT OF COTTON FROM U. S. Bales	PER CENT OF CHANGE FROM PREVIOUS YEAR.	EXPORT OF CORN FROM U. S. Bushels	PER CENT OF CHANGE FROM PREVIOUS YEAR	EXPORT OF WHEAT FROM RUSSIA Thousand cwt.	PER CENT OF CHANGE FROM PREVIOUS YEAR
1892	225,665,812		5,858,000		76,602,285		26,297	
1893	191,912,635	- 15	4,390,000	- 27	47,121,894	- 39	50,351	+ 91
1894	164,283,129	- 14	5,232,000	+ 19	66,489,529	+ 48	65,966	+ 31
1895	144,812,718	- 12	6,726,000	+ 29	28,585,405	- 57	76,453	+ 16
1896	126,443,968	- 12	4,627,000	- 31	101,100,375	+ 243	70,774	- 6
1897	145,124,972	+ 15	5,979,000	+ 29	178,817,417	+ 77	68,670	- 2
1898	217,306,004	+ 49	7,540,000	+ 26	212,055,543	+ 19	57,047	- 15
1899	222,618,420	+ 2	7,313,000	- 3	177,255,046	- 17	34,466	- 40
1900	186,096,762	- 17	5,946,000	- 19	213,123,412	+ 20	37,627	+ 9
1901	215,990,073	+ 15	6,538,000	+ 9	181,403,473	- 20	44,626	+ 19

Many of these fluctuations took the shipping trade by surprise, and either too few or too many boats were available. In other cases, the supply of shipping the world over was either excessive or redundant, and freights fell or rose to correspond.

So much for the temporary fluctuations of ocean freight rates and tonnage. There are also movements of longer duration, corresponding to the ebb and flow of general business, but subject in peculiar measure to the influence of special forces. From 1893 to 1897, for example, the leading commercial countries were suffering from a commercial depression which caused a general decrease in the tonnage of international trade, and a still greater fall in the value of exports and imports. The effect of this situation upon the shipping industry has been already indicated. Tonnage could not be decreased, and, in fact, the tonnage of the world during these three years increased. The result was an unprecedented depression in the shipping industry. In 1893, the *Economist's* review reports a large number of steamers laid up and a number disposed of at forced sale. In 1894, the report was "low, unprofitable freights and declining values of property

engaged; the whole of the enormous trade has brought little or no profit, and a very bare margin over working expenses, far from enough to cover depreciation." In 1895, came a year "which will not readily be forgotten by the ship owners. . . . Our anticipations have been to the full realized, and probably a worse year than the present has not been experienced by the very oldest in the business."<sup>1</sup> The condition of the trade, in 1896, as already remarked, was little better.

During the four succeeding years, the situation was entirely changed. The widespread industrial revival caused a large increase in the value of foreign trade; and the shipping trade, as illustrated by the rapid and extraordinary rise in the profits of the Cunard Company, became very profitable.<sup>2</sup> The main support of the market, during 1897 and 1898, was the American export trade, which was characterized in the *Economist's* annual review of 1897 as follows:

It contributed largely toward sustaining rates in the early months, and causing a material advance during the autumn and late summer in all other rates by the ready absorption and continued demand for tonnage of all descriptions from the leviathan 8,000 to 20,000-ton cargo boats, to small fruit steamers.<sup>3</sup>

In 1899 the advance continued. General trade, the world over, was active, and the South African War resulted in the largest withdrawal of shipping that had been known for more than a generation. An outbreak of hostilities, involving even a second-rate power, always demands the services of a large amount of shipping. Even the effect of the Greco-Turkish War was sensibly felt; the influence of the China-Japanese War has been already mentioned; and the Spanish-American War materially contributed to the prosperity of the trade in 1898. The shipping industry can, over a period of years, depend with reasonable

<sup>1</sup> *Economist*, vol. liv, supplement, p. 26.

<sup>2</sup> The combined exports and imports of the United States, Germany and Great Britain, in 1895 were valued at \$6,323,207,441. In 1901, six years later, their value had risen to \$8,635,362,581. A large portion of this increase was undoubtedly due to the rise of prices, but the gain in tonnage was chiefly responsible.

<sup>3</sup> *Economist*, vol. lvi, supplement, p. 24.

certainty upon the assistance of several wars. If international disturbances occur during a period of depression, the freight and traffic situation is relieved, and if, as in the case of the Boer War, the outbreak of hostilities comes hard upon the heels of general and abounding prosperity, the result is enormous profits for all ship-owners. Not only does war increase the demand for ships, usually on terms highly favorable to the owners, but it raises the level of freight the world over by reducing the supply of tonnage.

These results followed from the South African conflict. At the close of 1900, the British Government had withdrawn some 2,000,000 tons of shipping, an amount nearly equal to the total steam tonnage of Germany, and nearly double that of France. In 1900, moreover, the troubles in China required the transportation of large numbers of troops to the East, and throughout the Boer War, a large coal tonnage was kept moving to the Cape. The result, as stated in the *Economist's* annual review, was that

The tonnage taken on time charter for all trades during the past year has been unprecedented. The rates paid by our Government for transports were 20 s. per gross register per month, and in some cases more. Many charters in ordinary trades were made for long periods at very remunerative rates. Modern boats have commanded from 7 s. to 11 s. 6 d. per gross ton, according to the trade and length of charter.<sup>1</sup>

In 1901, however, the tide turned. During the preceding four years, the supply of tonnage had been increased 4,049,260 tons, and with the close of the war, the British government rapidly released the ships which it had employed. To make matters worse, the American corn crop was a failure, and the industrial depression on the continent reduced the amount of freight movement. Rates fell 30 per cent throughout the year, and have continued to fall during 1902 and 1903, the close of 1903 finding the trade extremely depressed, with little prospect of early improvement.

We find in this hasty review of the recent history of the shipping trade an explanation of the irregularity of the profits of the Cunard Company, and can understand why the directors have

<sup>1</sup> *Economist*, vol. lx, supplement, p. 28.

pursued such a niggardly policy in the disbursement of profits. The management of a shipping company lives in constant apprehension. Exposed to increasing competition on every hand ; compelled every year to build new and larger boats to keep pace with their rivals; anxiously scanning the commercial horizon for signs of business depression, crop failures, famines or labor disturbances; hoping and scheming for a few crumbs of subsidy, to introduce a modicum of fixed income into their earnings; engaged in a business as shifting and unstable as the sea on which that business is conducted — is it any wonder that the experienced ship-owners hold fast to their profits and regard the results of a year like 1900 as a gift of Providence to be guarded with zealous care?

Into this peculiar business came the promoters of the International Mercantile Marine Company. Attempting to apply to the shipping industry, the same principles of consolidation and capitalization which had been superficially successful on land, they imposed upon the new corporation an unusually heavy burden of capitalization, and they so arranged the capitalization as to make conservative financial management of the new company very difficult. The purchase price of most of the subsidiary companies was based on the profits of 1900. In the vendors' agreement between the syndicate and the White Star Line, for example, it was stated that

the valuation of the said shares hereunder and under said principal contract shall, subject as hereafter provided, be a sum equal to ten times the net profits of the company of the year 1900, subject to the following exceptions . . . (a) a sum for depreciation equal to 6 per cent on the amounts at which the property of the company stood on its books on the first day of January, 1900, and a sum for insurance . . . equal to £3 10 s. on the same amount . . .<sup>1</sup>

It was further stipulated that the earnings of steamships employed by the British government should "be credited . . . with net earnings of the same amount as were earned or would be

<sup>1</sup> For the text of these vendors' agreements, see Report of the U. S. Commissioner of Navigation, 1902, Appendix T, pp. 380 *et seq.*

earned by similar steamships of the company for the same periods in their ordinary trades."

The year 1900, as has been shown, was one of abnormal profits. The Cunard Company nearly doubled its net earnings, and it is reasonable to suppose that other companies were equally fortunate. A partial record of the prosperity of this year is furnished by the record of dividends. The average dividend of twenty-five leading companies in 1896 was 6 per cent ; in 1898, 7.7 per cent; and in 1900, 9.4 per cent. In the extract from the vendors' agreement quoted above, we find a recognition of the fact that the profits of 1900 were exceptional, *viz.*, the provision reducing the earnings of ships employed in the government service to the general average of private employment. This reservation, however, does not go far enough. The mere fact of a large government employment, as has been shown, was sufficient to heavily increase the earnings of ships in private employment, and in capitalizing the earnings of this single year, the promoters of the Shipping Trust made a serious mistake.

Indeed, so apparent was the mistake, and so clearly did the trade foresee that reaction was impending, that this fact was openly urged upon the shareholders by the Leyland Line as an inducement to fall in with Mr. Morgan's plans. Said Mr. Ellerman, in May, 1901, at the shareholders' meeting of Frederick Leyland and Company :

The outlook for freights in the near future is, in my judgment, an uncertain one. We have had prosperous times, and I feel that the near future may bring, at all events for a time, a reflux of bad times, particularly when the tonnage which is usually employed in the North Atlantic trade, but which is now employed in government transport work, returns to normal employment ; in addition to which a large amount of tonnage is building in America for employment in the Atlantic trade . . .<sup>1</sup>

Not only was the amount of capitalization excessive, but what was more important, the arrangement of the capital of the Shipping Trust, taken in connection with the amount of the different issues, was open to serious criticism. In addition to an amount

<sup>1</sup> Report of Commissioner of Navigation, 1901, p. 321.

of bonds fully sufficient to absorb the maximum earnings of the company, a liability of \$54,600,000 of cumulative preferred stock was assumed, all of whose passed dividends must be paid before the common stock receives anything. Our previous discussion has shown the shipping business to be so irregular that even with the most moderate capitalization, in some years dividends must be passed, and in other years paid out of reserve. At all times, the directors should have a free hand in determining whether profits shall be distributed to stockholders, used for replacements and depreciation, invested in securities, or held in cash. The irregularity of the business is so great, that a free disposition of profits to stockholders is out of the question. The policy of a well managed shipping company is dominated by the necessity of reserving from two-thirds to three-fourths of the profits in order that one-fourth may be paid out in dividends. In view of this fact, the absolute amount of the Shipping Trust's capitalization is of much less consequence than the nature of the liabilities which it includes. The fact that the company is excessively capitalized is of less consequence than the fact that the arrangement of this capitalization is such as to make prudent financial administration very unpopular with stockholders. In this arrangement, fixed charges and obligatory payments predominate. Of the \$170,600,000 of capital, \$122,600,000 consist of bonds and cumulative preferred stock. If the debenture interest is passed, while the form of the bonds puts foreclosure proceedings out of the question, the unpaid interest must be discharged before anything is paid on the preferred stock; and if the preferred stockholder is forced to await the convenience of the corporation, the hope of the common stockholder of receiving anything on his investment becomes remote. In other words, a conservative administration of the finances of the shipping consolidation involves a series of postponements, an accumulation of deferred claims. The collection of a reserve sufficient to pay dividends in years of depression, if we may judge from the experience of other companies capitalized on a basis similar to that of International Mercantile Marine, is likely to be seriously interfered with by the importunities of deferred claimants.

It would be going too far to say that the International Mer-



cantile Marine Company is a failure. Its future lies in the hands of the stockholders. If they will sanction a policy of conservatism in the distribution of earnings there is no reason to suppose that the preferred stock of the company may not eventually be raised to the rank of an investment. The unfortunate experience of the corporation up to the present time, however, emphasizes the fact that it is necessary, in arranging the capitalization of a new company, to take into careful account the conditions of the business in which the new concern is to operate, and in every case to assume that industrial history is to be repeated. The "economies of combination" are no doubt considerable, but they are too problematical to be safely included in an estimate of earnings available for distribution to stockholders.

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